

## Public Finance Ratings



### Research:

## Sector Review: Russian Local and Regional Governments

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### ■ Overview of Trends

Several trends have been observed in the Russian local and regional government (LRG) sector over the past few years. In 2004, the following trends have first appeared or been reinforced:

- Growing debt issuance, while debt levels remain modest;
- Expanding economies leading to higher revenues on average, despite revenue redistribution between layers of government;
- Increasing operating expenditure pressures, owing to rising public sector salaries and fuel prices;
- Overall financial performance remaining sound, although operating margins have started to shrink in many regions;
- Growing reliance of municipalities on budget loans and increased levels of revenue redistribution within regions;
- Increasing political and administrative pressure from the central government, such as the appointments of governors and the mergers of Okrugs and regions;
- Higher levels of transparency and management sophistication; and
- Overall improving creditworthiness, although the pace will slow in the future.

This Russian LRG sector report reviews some of these important trends and provides more detailed comparative information on the 21 Russian LRGs rated by Standard & Poor's Ratings Services.

## ■ Growing Debt Issuance

Despite the low debt levels at present, Russian ruble (RUR) debt issuance by Russian LRGs is growing. Many regions and cities entered the bond market in 2004. As of October 2004, the Russian subfederal bond market stood at approximately RUR120 billion (\$4.2 billion), compared with RUR83 billion at the beginning of the year. This market accounts for 14.4% of the national bond market, with 30 issuers (27 regions and three cities) participating. With 21 issuer credit ratings in the sector (17 regions and four municipalities) Standard & Poor's covers 87% of the subfederal bond market.

Standard & Poor's expects that the rapid growth in the number of issuers and the amount of debt will continue, due to large infrastructure needs on both regional and local levels, combined with the current low debt levels. The total amount of regional bonds outstanding is only 7% of expected regional budget revenues in 2004, compared with 6% in 2003. On the municipal level, the amount of bonds issued is insignificant, with only four issuers active in the market. Although the number of municipal issuers and the amount of issuance is expected to grow, debt levels will on average remain low in the next few years.

Legal restrictions on foreign currency issuance continue to limit LRGs' access to the cheaper financing sources with longer maturities, and slow down implementation of necessary infrastructure projects. The restrictions do, however, lessen the currency risks.

## ■ Expanding Economies Leading to Growing Revenues

The majority of the Russian LRGs experienced a strong increase in revenues in the first nine months of 2004, especially from corporate profit and personal income tax (see Table 1). This increase was fueled by strong economic development in The Russian Federation (foreign currency BB+/Stable/B; local currency BBB-/Stable/A-3), with GDP and industrial output growth of 6.5% and 6.3%, respectively, in the first nine months of 2004. Rapid revenue growth was observed particularly in the regions with oil and ferrous metallurgy production, reflecting higher prices for their products on the world market.

In some regions—for example, Irkutsk Oblast (foreign currency B/Stable/--) and the Republics of Sakha (Yakutia) (ruA-) and Chuvashia—total revenues declined in the first three quarters of 2004, even though tax revenue increased. The overall decline was due to reductions of federal subsidies and transfers from other entities.

In other regions, including the Republic of Bashkortostan (BB-/Stable/--) and Yaroslavl Oblast, revenues decreased mainly as a result of the reduction of excises for mineral oil goods. The revenue from these excises was higher than budgeted in 2003, but decreased in 2004 because of changes to the legislation on excise redistribution between the regions.

The major concern for future revenue development in the regions is a slowdown of GDP and industrial output growth, registered in Russia in the third quarter of 2004, and growing political and policy uncertainty, which may worsen the investment climate in Russia. Furthermore, the federal policies toward OAO NK Yukos (CC/Watch Neg/--) have negatively affected the tax base of four rated Russian regions: Khanty-Mansiysk Autonomous Okrug (KMAO), Samara Oblast (both rated foreign currency BB-/Stable), Tomsk Oblast (ruA), and Irkutsk Oblast (foreign currency B/Stable/--). If the GDP and industrial output slowdown continues further, the regional revenues may be affected. In this case, the ratings on the regions will depend in many respects on their management's ability to control expenditure growth and, consequently, the financial balance.

## ■ Increasing Pressures From Rising Public Sector Salaries

Personnel expenditure (salaries, together with payments to various social funds) has been growing faster than other expenditure of the Russian LRGs and has continued to put pressure on the regional and local budgets. The average share of personnel expenditure in 2003 exceeded 12% of total expenditure on the regional level and 36% on the local level, up from 9% and 29%, respectively, in 2000.

Growth in personnel expenditure was driven both by the low level of salaries, and by the federal government decisions to raise salaries for public servants. The salaries in the public sector are still lagging those in the labor market and are expected to grow, on average, faster than budget revenues.

As a result, Russian LRGs' operating expenditure will be under pressure in the medium term, which may lead to a deterioration in their financial performance.

## ■ Sound Financial Performance, but Shrinking Margins

Most regions have shown sound financial performance, with small negative, or even positive, balances after capital expenditure since 2000 (see Table 1). Financial performance has been deteriorating in many regions, however, compared with its 2000-2002 peak levels.

Growth in salaries and social spending is expected to continue, and to adversely affect financial performance, with single-digit operating surpluses in the next few years expected on average, versus the double-digit surpluses of 2000-2002. The extent to which financial performance worsens is subject to management's ability to keep staff numbers under control, and to federal policies on public servants' compensation. The strongest rated LRGs such as the Cities of Moscow (foreign currency BB+/Stable/--), St. Petersburg (BB+/Stable/--), KMAO, Samara Oblast and Bashkortostan Republic, however, currently demonstrate sound financial performance, which is expected to continue at least for the next few years.

While financial performance on the municipal level has also been on average sound since 2000, this performance has been hiding significant issues including dependence on budget loans and payables, and the underfinancing of infrastructure. The most important developments for Russian municipalities in 2003-2004 are the growth in housing and utilities tariffs, and the expected reform of social benefits. Cash will be paid instead of benefits in kind, which previously had resulted in losses and payables of municipal housing and transport companies. In addition, the expected improvement in the performance of housing utilities, and the growing transparency of social assistance, will enable LRGs to limit expenditure growth on the municipal level. Accumulated debts of the housing sector by the end of 2003, however, were almost 6% of the total municipal budget revenues and remain a concern. Housing, utilities, and social welfare reforms remain vital for the improvement of creditworthiness at the municipal and, to a lesser extent, the regional level.

## ■ The Effect of Budget Loans, Revenue Redistribution, and Municipal Reform on Municipalities

In the context of ongoing revenue and expenditure redistribution, many regions are transferring risks to the municipal level. The current trend toward increased redistribution of revenues to the federal and regional budgets further constrains flexibility on the local level. The share of interbudgetary revenues on the local level is growing: it exceeded 40% in 2003, while it was less than 30% in 2000.

Budget loans from the regional budgets remain the main source of deficit financing for the local governments. In some regions, like the Moscow Oblast (foreign currency BB-/Stable/--), the amount of budget loans attracted by the municipalities in course of the year may be comparable with the amount of their budget revenues. The risks related to these policies are caused by high short-term debt levels, low financial predictability, and a high dependence on relations with the regional authorities. Such risks put significant downward pressure on the creditworthiness of the local governments.

The 2006 municipal reform, with two unequal levels of municipal governments emerging, creates much uncertainty over the future responsibility for existing municipal debts, redistribution of revenues and expenditures, and property rights among the new entities and the regions. Although the ultimate goal of the reform is a more clear and transparent division of responsibilities between the levels of government, the details of its implementation are still unclear, and risks remain high.

## ■ Political and Administrative Developments

Several new important changes reflect the centralization trends in the Russian interbudgetary system and add uncertainty on both regional and municipal levels. Mergers of regions, and redistribution of responsibilities between the autonomous Okrugs and regions that incorporate the Okrugs, may lead to disputes over responsibility for debt obligations, revenue sources, expenditures, and property. This, in turn, may lead to a mismatch between revenues and expenditures. Uncertainty regarding the relations with the Tyumen Oblast has already affected the two wealthy autonomous Okrugs, KMAO, and Yamal-Nenets Autonomous Okrug (foreign currency B+/Stable/--) during 2004. Although the agreement on revenue and

expenditure redistribution between the three regions has been signed, the risks are still higher than in other regions with the different status. The administrative costs of the reforms may also be high.

The governors of the Russian regions are currently elected by the popular vote. According to the draft law, approved by the Russian Duma (lower chamber of Russian parliament), beginning from 2005, they will be nominated by the president, with the approval of the regional parliaments. If the president's candidate is rejected by the regional parliament twice, his options are to dismiss the parliament and appoint an acting governor for six months, or hold another round of consultations with the parliament and propose a candidate once more. The president also will be able to dismiss the governors. Those governors elected already will be able to stay in power until the end of their terms. There is a certain risk that these changes will harm the continuity of regional economic, financial, and debt policies, and negatively affect the investment climate and level of management sophistication. It may even affect the willingness of LRGs to repay existing debts attracted under previous governors, as happened in several Russian regions in the past. It is likely that the new governors will get additional responsibilities, including security, which may lead to additional pressures on the regional budgets. On the other hand, the change is supposed to provide more consistency in regional policy throughout Russia.

Another point of concern continues to be the availability of federal budget loans to the regions. Recently, the federal government decided again to extend and even write off some of the budget loans that regions owe to the federal budget. The loans due in 2004 could be prolonged until 2008, and up to 90% could be written off, subject to the decrease in payables and timely salary payments from the regional budgets. Only the regions with budget loans exceeding a certain share of their budget (1%-2%) will be able to use this opportunity. These policies reduce credit discipline, encouraging the regions to rely on budget loans.

## ■ Low but Improving Levels of Transparency and Management Sophistication

The transparency of LRG operations and finances has continued to improve in 2003-2004. Center-led changes included further improvement in accounting and reporting, with extended obligatory classification of expenditures, the introduction of medium-term budget planning, continued work on consolidation of off-budget funds and accounts, gradual transfer to treasury management of finances, restructuring of disputable obligations, and other changes. LRGs themselves have continued to improve transparency by publishing more (and better quality) financial data on their Web sites and adopting long-term debt-management concepts, while refining treasury management and internal equalization systems. Importantly, many leading Russian LRGs have already started to institutionalize these changes.

One of the strongest teams in public finance debt management is St. Petersburg's debt committee, followed by the City of Moscow, the reformed Moscow Oblast, and certain other LRGs. St. Petersburg has detailed and up-to-date financial information on its Web site; furthermore, it is one of the leading Russian LRGs in terms of innovative debt instruments and good practices in treasury and debt management.

Despite all these improvements, there are still significant unresolved issues, including:

- Low transparency and insufficient monitoring of municipal and regional enterprises and their liabilities, as well as LRG properties;
- Still low and underdeveloped debt-payment culture, especially related to guarantees;
- Nontransparent decision-making systems, with a lack of accountability, checks and balances;
- Still strong local government involvement in local economies and risky commercial ventures;
- Persistent off-budget handling of significant amounts of revenues;
- Incoherent budgeting and forecasting (exacerbated by the rapidly changing intergovernmental system and economic environment, as well as lobbying); and
- The absence of accrual accounting, with no independent auditing of accounts and operations.

With few exceptions, Standard & Poor's still views the level of transparency of Russian LRGs as low in the international context, and considers it a significant constraining factor for their ratings in the next two-to-three years. Adopting best practices in transparency, governance, and management, could directly improve LRGs' creditworthiness and ratings.

## ■ Improvements in Creditworthiness Set to Continue, but Pace May Slow

There were no downgrades or negative outlooks assigned to Russian LRGs by Standard & Poor's in 2003 and 2004. Eight out of 10 LRGs rated as of Jan. 1, 2003 were upgraded (some of them a few times) during this period. One CreditWatch Negative situation (KMAO, prior to signing agreement with the Tyumen Oblast) has been resolved with affirmation of the original 'BB-' rating. Standard & Poor's has assigned 12 new ratings during this period, marking an important growth in credit-rating culture. Only two out of 21 LRG ratings in Russia currently have positive outlooks, however, compared with six out of 10 in January 2003. This highlights a certain stabilization of credit quality after a number of years of rapid improvement since Russia's default in 1998.

The main constraining factors common to most rated Russian LRGs are:

- Low revenue flexibility, owing to federal government controls over revenue sources, and ongoing interbudgetary reform;
- Further centralization of revenues, decision-making powers, and ongoing administrative reforms;
- Increasing pressure from operating expenditure (for example, from growing public sector salaries) leading to decreasing operating balances, with few exceptions;
- Significant infrastructure needs;
- Insufficient transparency of operations and finances; and
- Continued underdevelopment of services, often exacerbated by economic and tax concentration.

At the same time, there are several supportive factors, including:

- Still sound financial performance, characterized by moderate-to-low deficits after capital expenditure;
- Growing, albeit slowing, economies and revenues;
- Still relatively low debt levels; and
- Improving transparency and management sophistication, although further efforts are needed.

While Standard & Poor's expects to see continued improvement in the creditworthiness of Russian LRGs, the pace will slow in the next two-to-three years, owing to increasing pressure from public sector salary growth, strong revenue and decision-making centralization trends, slowing economic growth, and further intergovernmental reform. Improvements in LRGs' management sophistication, transparency of finances and operations, maintenance of conservative debt levels, and development of services will be important for the LRGs' creditworthiness and potential rating upgrades. The gap between stronger and weaker LRGs, in terms of creditworthiness and ratings, will continue to grow.

## ■ Comparative Data

Table 1 Comparative Data on Selected Russian Regional and Local Governments

	<i>Publicly traded debt as at Nov. 1, 2004 (Bil. RUR)*</i>	<i>Budget revenues 2003 (Bil. RUR)†</i>	<i>Budget revenues as at Sept. 30, 2004 (Bil. RUR)‡</i>	<i>Budget revenue growth in 2004 year-on-year (% , inflation adjusted)</i>	<i>Consolidated revenues per capita, 2003</i>	<i>Balance after capital expenditure, % of total revenues 2003</i>	<i>GRP average growth in 2001-2003 (%)</i>	<i>Population 2003 (Mil.)§</i>
<b>Regions rated by Standard &amp; Poor's</b>								
Bashkortostan (Republic of)	0.5	37.8	21.0	(30.7)	15.4	10.5	6.4	4.1
Irkutsk Oblast	1.6	16.1	12.2	(1.3)	13.0	0.5	2.7	2.6
Kaluga Oblast	N.A.	7.4	6.3	8.8	12.2	2.1	5.7	1.0
Khanty-Mansiysk Autonomous Okrug	4.0	67.3	61.7	19.4	85.0	(0.1)	7.1	1.5

	<i>Publicly traded debt as at Nov. 1, 2004 (Bil. RUR)*</i>	<i>Budget revenues 2003 (Bil. RUR)¶</i>	<i>Budget revenues as at Sept. 30, 2004 (Bil. RUR)¶</i>	<i>Budget revenue growth in 2004 year-on-year (%; inflation adjusted)</i>	<i>Consolidated revenues per capita, 2003</i>	<i>Balance after capital expenditure, % of total revenues 2003</i>	<i>GRP average growth in 2001-2003 (%)</i>	<i>Population 2003 (Mil.)§</i>
Krasnodar Krai	0.6	24.9	22.5	16.7	10.5	(0.3)	2.9	5.1
Leningrad Oblast	1.2	13.0	10.6	1.2	13.4	(5.9)	13.6	1.7
Moscow (City of)	64.0	346.7	281.2	0.4	33.4	(2.3)	6.9	10.4
Moscow Oblast	14.6	48.4	41.7	11.1	14.0	(1.2)	8.4	6.6
Sakha (Yakutia, Republic of)	3.8	33.7	24.7	(7.2)	49.2	(4.8)	1.3	1.1
Samara Oblast	1.2	18.8	18.5	25.8	11.0	0.9	5.0	3.2
Stavropol Krai	N.A.	14.2	12.0	9.9	7.8	3.6	5.9	2.7
St. Petersburg (City of)	9.9	76.0	65.5	6.3	17.0	(0.8)	10.4	4.6
Sverdlovsk Oblast	N.A.	22.2	21.7	22.5	10.5	(1.3)	7.1	4.4
Tatarstan (Republic of)	N.A.	45.2	40.9	13.0	18.2	(1.4)	6.3	3.8
Tomsk Oblast	1.6	9.6	8.3	6.4	16.7	(1.9)	11.4	1.0
Vologda Oblast	0.2	9.6	11.5	45.4	15.0	6.4	2.7	1.3
Yamal-Nenets Autonomous Okrug	1.8	28.9	23.0	(5.3)	122.8	6.6	10.3	0.5
<b>Municipalities rated by Standard &amp; Poor's</b>								
Balashikha Rayon	N.A.	1.1	N.A.	N.A.	N.A.	(2.5)	N.A.	0.2
Klin Rayon	N.A.	1.3	N.A.	N.A.	N.A.	(2.4)	N.A.	0.1
Surgut (City of)	N.A.	11.1	N.A.	N.A.	N.A.	2.2	N.A.	0.3
Ufa (City of)	0.9	5.8	N.A.	N.A.	N.A.	(2.4)	N.A.	1.1
<b>Regions not rated by Standard &amp; Poors with publicly traded debt issues</b>								
Karelia (Republic of)	0.5	5.6	5.5	26.6	14.7	(4.9)	0.6	0.7
Belgorodskaya Oblast	0.6	6.5	7.6	51.6	8.8	(0.6)	4.9	1.5
Chuvashia (Republic of)	0.8	8.6	6.9	(3.2)	11.5	0.6	5.2	1.3
Khabarovsk Krai	1.0	18.7	14.7	(0.0)	22.2	3.1	7.4	1.4
Komi (Republic of)	1.6	10.1	12.9	67.8	20.5	5.9	2.7	1.0
Kostromskaya Oblast	0.3	4.5	3.5	(4.8)	11.7	(0.5)	2.8	0.7
Krasnoyarsk Krai	3.0	21.1	21.8	40.8	18.9	(9.9)	5.3	2.9
Murmansk Oblast	0.5	6.4	6.0	25.3	16.7	(3.1)	0.9	0.9

	<i>Publicly traded debt as at Nov. 1, 2004 (Bil. RUR)*</i>	<i>Budget revenues 2003 (Bil. RUR)¶</i>	<i>Budget revenues as at Sept. 30, 2004 (Bil. RUR)</i>	<i>Budget revenue growth in 2004 year-on-year (% , inflation adjusted)</i>	<i>Consolidated revenues per capita, 2003</i>	<i>Balance after capital expenditure, % of total revenues 2003</i>	<i>GRP average growth in 2001-2003 (%)</i>	<i>Population 2003 (Mil.)§</i>
Nizhniy Novgorod Oblast	N.A.	16.1	14.9	21.6	9.2	(5.1)	6.4	3.5
Novosibirsk Oblast	1.5	16.9	12.0	(4.7)	11.1	(3.3)	8.7	2.7
Sahalin Oblast	N.A.	8.3	7.4	12.6	31.0	0.1	19.6	0.5
Tver Oblast	1.0	8.2	6.7	1.9	10.6	(3.5)	2.6	1.4
Volgograd Oblast	1.1	11.2	8.3	0.7	8.4	2.7	6.4	2.7
Yaroslavl Oblast	1.0	8.5	5.0	(22.6)	14.2	(9.0)	6.3	1.4
<b>Municipalities not rated by Standard &amp; Poors with publicly traded debt issues</b>								
Krasnoyarsk (City of)	1.3	7.9	N.A.	N.A.	N.A.	N.A.	N.A.	0.9**
Novosibirsk (City of)	1.5	9.2	N.A.	N.A.	N.A.	N.A.	N.A.	1.4***
*Source: www.cbonds.ru ¶Source: www.minfin.ru §Source: Goskomstat RUR--Russian ruble. GRP--Gross regional product. N.A.--Not available.								

## ■ Issuer Review

Table 2 Russian Regional and Local Governments				
<i>Issuer</i>	<i>Issuer credit rating</i>		<i>Analyst</i>	<i>Strengths and weaknesses*</i>
	<i>Foreign Currency</i>	<i>Russian national scale</i>		
Bashkortostan (Republic of)	BB-/Stable/-	N/A	Felix Ejgel	Strengths: low debt burden; relatively high liquidity; and stable, strong budget performance.
				Weaknesses: concentration of major taxpayers in the oil and oil-processing industries; the need to increase transparency; high level of contingent liabilities; and continuing dependence on federal government transfers.
Vologda Oblast	B/Stable/--	ruA-	Boris Kopeykin	Strengths: a positive credit history; low direct debt; and low contingent liabilities.
				Weaknesses: significant concentration in the ferrous metallurgy industry, represented by OAO Severstal (B+/WatchDev/--); relatively high foreign currency exchange risk; and a need to improve planning procedures under low revenue stream predictability.
Irkutsk Oblast	B/Stable/--	N/A	Boris Kopeykin	Strengths: a growing and diversifying economy, with good growth prospects; low direct debt; and currently sound financial performance.
				Weaknesses: some medium-term managerial and political uncertainty; high municipal payables; and low level of investments.
Khanty-Mansiysk Autonomous Okrug	BB-/Stable/-	ruAA	Boris Kopeykin	Strengths: low debt burden and high liquidity; wealth levels one of the highest in Russia; economic growth above the Russian average; and competent and focused management.



<i>Issuer</i>	<i>Issuer credit rating</i>		<i>Analyst</i>	<i>Strengths and weaknesses*</i>
	<b>Foreign Currency</b>	<b>Russian national scale</b>		
				Weaknesses: industry and tax-revenue concentration in the oil sector. More than 70% of all tax revenues come from Russia's five largest oil-producing companies; uncertainties regarding the region's status and long-term implementation of new revenue-sharing agreement with the Tyumen Oblast; and some contingent liabilities.
Moscow (City of)	BB+/Stable/--	N/A	Elena Okorotchenko	Strengths: Moscow's role as the economic, political, and financial center of the Russian federation; diversified, service-based economy with high wealth levels in the Russian context; sound budgetary performance; and low debt burden in the international context and continued improvement of the city debt management.
				Weaknesses: foreign currency risk exposure; and high contingent liabilities owing to Moscow's ownership or support of a number of enterprises and a bank.
Moscow Oblast	BB-/Stable/--	ruAA-	Felix Ejgel	Strengths: proximity to the City of Moscow, which supports investment and economic development; high management sophistication in the Russian context; and improving debt structure, with longer maturities.
				Weaknesses: low flexibility due to pressures from planned personnel expenditure growth; quite aggressive financial and investment policy; and high infrastructure needs.
St. Petersburg (City of)	BB+/Stable/--	N/A	Elena Okorotchenko	Strengths: sophisticated debt management; low debt burden with reduced foreign exchange risks; growing revenues and sound budgetary performance; and growing economy and developing service sector.
				Weaknesses: industrial volatility due to exposure to heavy machinery production; and significant need to improve infrastructure.
Sverdlovsk Oblast	B/Positive/--	N/A	Elena Ershova; Felix Ejgel	Strengths: a growing and relatively diversified economy. Sound financial performance with high average operating balances. Low debt. The administration does not plan to issue any significant new debt or guarantees over the next two to three years.
				Weaknesses: large investment needs in infrastructure and industry, which are crucial for sustained economic, financial, and wealth growth; a need to improve management systems and financial and operational transparency; and the relatively weak financial performance of state-owned enterprises and the municipal sector, reflected in a high level of payables.
Tatarstan (Republic of)	B-/Positive/--	N/A	Felix Ejgel	Strengths: good budgetary performance, with a positive operating balance of about 30%, and a positive balance after capital expenditures expected in 2004; low direct debt; and expected further revenue growth.
				Weaknesses: concentration in the oil sector; high level of contingent liabilities with extensive involvement in the economy; and in addition, the Republic's management is not sufficiently risk-averse, and needs to improve transparency.
Yamal-Nenets Autonomous Okrug	B+/Stable/--	RuA+	Felix Ejgel	Strengths: a wealthy economy within the Russian context with the highest gross regional product per capita; sound financial performance; and low debt burden.
				Weaknesses: significant concentration in natural gas extraction. The Okrug's economy is highly dependent on production decisions by OAO Gazprom (BB-/Developing/--) the medium-term risk of further revenue redistribution to the federal budget and the Tyumen Oblast, of which Yamal-Nenets is a part. The five-year agreement between the Okrug and the Oblast, however, has been signed recently. High seasonality of the Okrug's liquidity position.
Surgut (City of)	B/Stable/--	ruA-	Elena Okorotchenko	Strengths: high wealth. Surgut is one of the wealthiest cities in Russia, with per capita budgetary expenditure and salaries among the highest in the country; debt burden, which is expected to remain moderate; rapid industrial output growth; a comparatively good level of financial management; and expenditure flexibility above the Russian average.
				Weaknesses: high concentration in the oil sector. More than 37% of the city's tax revenues come from the third-largest Russian oil company, JSC Surgutneftegas; and uncertainties created by the redistribution of revenue and expenditure responsibilities between KMAO, where Surgut is located, and Tyumen Oblast.



<i>Issuer</i>	<i>Issuer credit rating</i>		<i>Analyst</i>	<i>Strengths and weaknesses*</i>
	<b>Foreign Currency</b>	<b>Russian national scale</b>		
Sakha (Republic of)	N/A	ruA-	Felix Ejgel	Strengths: moderate debt burden; relatively high budget revenues per capita; and improving financial management.
				Weaknesses: high dependence on Alrosa Co. (B/Stable/--) diamond producer; significant contingent liabilities, due to location; poor liquidity; and high seasonality of budget revenues and expenditures.
Leningrad Oblast	B+/Stable/--	ruA+	Boris Kopeykin	Strengths: Leningrad's continued fast economic expansion; strategic location of the Oblast, which lies on the main trade route to the EU in the Baltic region and is also near the City of St. Petersburg; and moderate debt.
				Weaknesses: deteriorating financial performance, due to both operating and capital-expenditure pressures; poor debt history; and low revenue flexibility due to federal controls.
Klin Rayon	B-/Stable/--	ruBBB-	Felix Ejgel	Strengths: fast economic growth, fuelled by a sizable inflow of foreign and domestic investments (one-third of total foreign direct investment in Moscow Oblast); and strategic location on the main highway between Moscow and St. Petersburg.
				Weaknesses: high dependence on transfers and budget loans from Moscow Oblast's budget, which results in volatile financial performance; and uncertainty created by the upcoming municipal reform. Another layer of self-government, which will emerge from 2006 as an essential part of the municipal reform in Russia, may swallow a significant part of Klin's budget.
Balashikha Rayon	B-/Stable/--	ruBBB	Boris Kopeykin	Strengths: rayon's growing and diversifying economy; a strategic location near the City of Moscow; adequate budgetary performance; and low debt and good track record.
				Weaknesses: risky financial and liquidity policy, with high cash shortages during the year due to complex interbudgetary relationships with the Moscow Oblast; and potential changes to the rayon's structure, responsibilities, and revenues owing to the upcoming reform of local government in Russia.
Ufa (City of)	B/Stable/--	ruA+	Boris Kopeykin	Strengths the city's expanding economy with good growth prospects; prudent financial policies; low debt; and above average wealth levels.
				Weaknesses: ongoing municipal reform. The reform may cause reshuffling of revenues and expenditure responsibilities between different levels of government, which may result in a temporary mismatch of city revenues and expenditures after 2005. Large, although decreasing industry and taxpayer concentration in the petrochemical industry. Exposure to commercial risks owing to budget loans provided by the city to the local enterprises.
Kaluga Oblast	B+/Stable/--	ruA+	Felix Ejgel	Strengths: favorable prospects for continued economic growth. Kaluga Oblast is expected to benefit from the City of Moscow's development, like the Moscow Oblast, but with some time lag; sound budgetary performance; and comparatively low debt burden.
				Weaknesses: low wealth levels; high financing needs for the improvement of social, communal, and housing infrastructure; and high dependence on federal subsidies.
Tomsk Oblast	N/A	ruA	Boris Kopeykin	Strengths: continuous fast economic growth in the region; sophisticated financial and debt management; improved liquidity; and good credit history.
				Weaknesses: Tomsk Oblast is highly dependent on its largest taxpayer, oil company Tomskneft, which provides up to 30% of the Oblast tax revenues and is the subsidiary of OAO NK Yukos (CC/Watch Neg/--); comparatively high debt service and relatively short maturities; and relatively high debt service.
Stavropol Krai	B/Stable/--	ruA-	Boris Kopeykin	Strengths: sound financial performance; low debt; improving financial and debt management; and high economic growth rates.
				Weaknesses: unfavorable location near the Chechen Republic, which creates budgetary pressures and hinders investments; low revenue flexibility and wealth levels; low wealth levels; and a poor debt service record.

<i>Issuer</i>	<i>Issuer credit rating</i>		<i>Analyst</i>	<i>Strengths and weaknesses*</i>
	<b>Foreign Currency</b>	<b>Russian national scale</b>		
Krasnodar Krai	B+/Stable/--	ruA	Boris Kopeykin	Strengths: low debt burden; the pro-business style of its management; and its well-diversified economy, which has strong potential for sustainable growth.
				Weaknesses: high dependence on federal subsidies; relatively low wealth levels; and large infrastructure needs.
Samara Oblast	BB-/Stable/--	ruAA-	Boris Kopeykin	Strengths: continued economic expansion with diversification slightly improving; sound financial performance; comparative wealth of the region; and competent management.
				Weaknesses: high dependence on its largest taxpayer, Avtovaz. This company, with its subsidiaries, is the Oblast's largest taxpayer, contributing up to 30% of tax revenues. Relatively high level of guarantees.
*All Russian LRGs' ratings are constrained by low revenue predictability and flexibility due to evolving tax and intergovernmental reforms and federal control over tax rates, shares and collection. Their specific strengths and weaknesses are outlined in the table. N/A--Not applicable.				

## ■ Selected Articles

<b>Table 3 Previously Published Related Articles*</b>	
<b>Article Title</b>	<b>Publication date</b>
<i>Law Amendments Bring Stability for Russian LRGs Longer Term but May Affect Finances Near Term</i>	<i>Aug. 20, 2004</i>
The report discusses in detail further tax changes in 2005, the gradual resolution of unfunded federal mandates, devolution of decision-making on certain responsibilities to regional governments, stabilization of responsibilities from 2005. Also examined are certain changes in government administrative structure that could affect particular formations, such as Autonomous Okrugs within regions, or municipal levels, given the creation of new municipalities and redefining of municipal borders.	
<i>How Much Is a Guarantee Worth in the Public Sector?</i>	<i>July 29, 2004</i>
This article focuses on guarantees provided by LRGs worldwide, with a particular focus on Russia. There are circumstances where the guaranteed obligation may have a different creditworthiness from the LRG's because, although the LRG's ability to pay on such obligations and direct debt may be (and usually is) the same, its willingness and commitment to pay could be quite different. This might have a detrimental effect on when (if at all) the guaranteed obligation will be ultimately serviced.	
<i>Ratings on Four Russian Regions As Yet Unaffected by Yukos Tax Freeze</i>	<i>Sept. 12, 2004</i>
The bulletin reflects Standard & Poor's view on possible short-term effects of the OAO NK Yukos (CC/WatchNeg/--) deal on rated regions.	
<i>Non-U.S. Local and Regional Governments Face Constraints From Support for Public Service Providers and the Commercial Sector</i>	<i>July 9, 2004</i>
The transfer of public services provision to the private sector by non-U.S. local and regional governments (LRGs) in most cases does not absolve the LRG from the responsibility of service provision. Moreover, it can cause significant off-balance-sheet (OBS) liabilities for LRGs, which is often the case in Russia	
*Articles are available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at <a href="http://www.ratingsdirect.com">www.ratingsdirect.com</a> .	

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